RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Mar. 16, 1994 **LETTER 1143**

Mar. 4 DJIA 3832.30; PTI 4076; A-D Ratio -2.81
Mar. 11 DJIA 3862.70; PTI 4077; A-D Ratio -2.90
Dow Yield: 3.82%; Dow Price/Earnings: 26.1
Dow 200-day MA: 3672; Dow 30-day MA: 3895
Dow Times Book Value: 3.37; PTI 89-day MA: 4040
Percentage of Undervalued Blue-chips: 9%
Dow Low Risk Buy Index: +141; Gold-PTI: 1029
Gold 40-week MA: 378

WE PLANNED IT: In 1936, during the midst of the Great Depression, business suddenly started to pick up. Startled by the sudden lift, newspaper reporters asked President Roosevelt why the economy was improving. Boastfully Roosevelt answered, "We planned it that way." The next year the stock market crashed (Dow down over 50%) while the economy sank back into depression. The 1937 collapse wasn't in Roosevelt's plans.

A few weeks ago President Clinton told Congress that the economy would continue to expand to the end of the century -- as long as interest rates stay low (hint, hint to the Fed?). Let's hope Clinton's predictions turn out to be better than Roosevelt's.

BEAR MARKET? Has a bear market started? The truth -- there's absolutely no way of knowing -- yet. As far as the Dow Theory is concerned, here's what we would need for a bona fide primary bear market signal. First, we'd need a FULL secondary reaction lasting a few weeks or longer. We would then need an upward retracement. If, on the upward correction, the two Averages (D-J Industrials and Transports) advance to new highs, all is well. But if on the upward move one or both Averages fail to record new highs, and they then turn down, the picture becomes ominous. For on the second decline, if both Averages then break below their preceding reaction lows, a primary bear market will have been signaled under Dow Theory.

Current status: The stock market's first downward leg seems still to be underway. It's what happens following this downward leg which will be crucially important in determining the trend.

What do we, as investors, do about the situation? The Dow Theory concerns itself above all with values. Since on orthodox measurements, this market is, and has been, flagrantly overvalued, we are basically out of the market. We're liquid, in T-bills, money markets accounts and in gold instruments. To put it succinctly, we're sitting back and watching the Big Show.

What about my Primary Trend Index (PTI)? In the last Letter I showed that the PTI has violated a long rising trendline, a trendline that has contained all the action since January 1993.

The violation of the 14-month-long trendline is important (see page 2 chart), but I will to stick with my time-honored, mechanical method of gauging the PTI. Which is that as long as the PTI is fluctuating ABOVE its 89-day moving average it is bullish, while conversely, as long as it is fluctuating BELOW its 89-day MA it is bearish. On those criteria, I continue to label the PTI as bullish.

Meanwhile, the advance-decline ratio formed a head-and-shoulders top -- and then broke badly. So the A-D too can also be considered suspect. But as with the PTI, I want to see more.

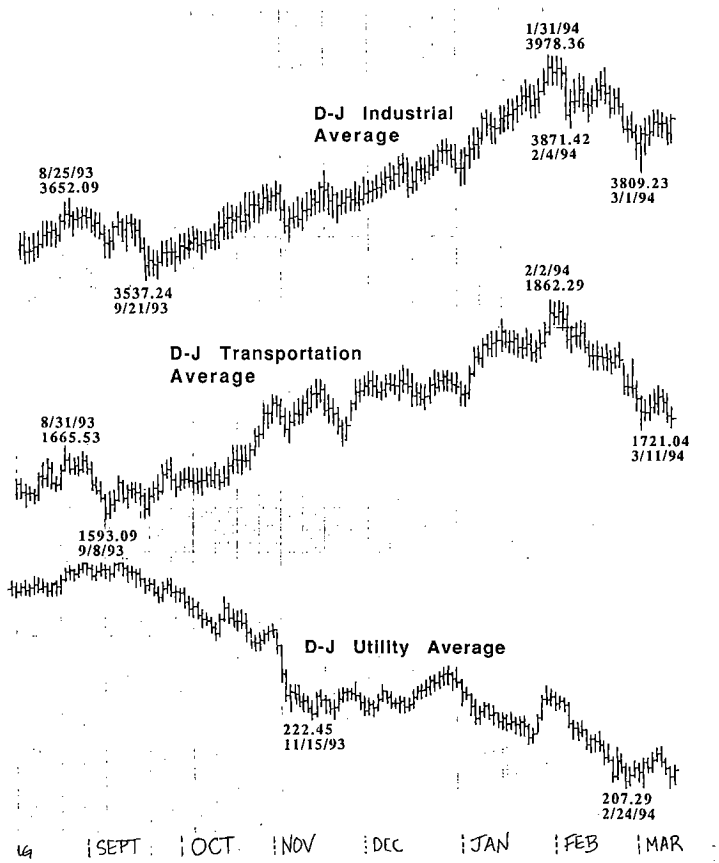
LOOKING AHEAD: Last week I heard a well-known market analyst make this statement: "I remain bullish. Interest rates are low, the economy is humming, and I don't see anything on the horizon to justify a bear market."

This is a common way of "thinking" among many youngish analysts, people who have been watching the market for maybe five or ten years. They've never seen a real bear market. And they don't understand that the stock market discounts, it looks ahead. All statistics, all news, everything you see on CNBC or read in the *WSJ* -- is history. Bear markets don't start when analysts detect hints of danger in the distance. Bear markets begin when the economic lights are shining brightest, and when there isn't a cloud in the sky. Bear markets start when the consensus is that "business can't get any better."

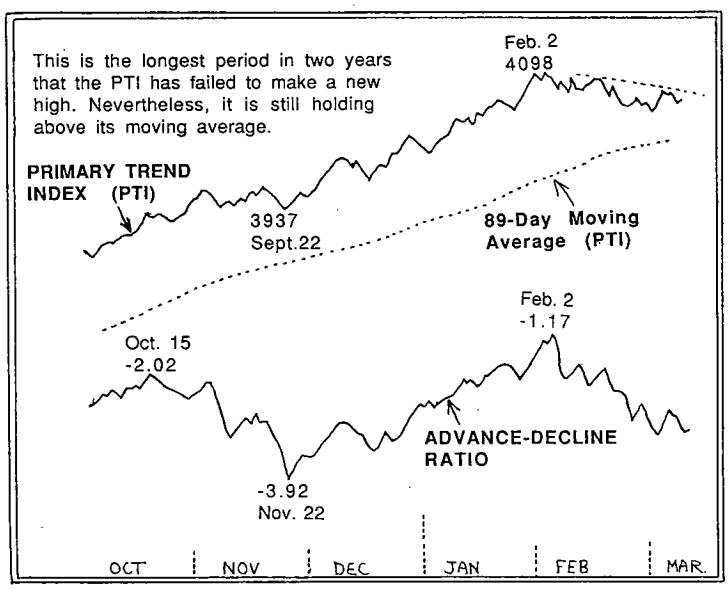
Ironically, when it can't get any better, then the only thing that can happen is that conditions can get worse. And that's exactly what bear markets discount. It's also why analysts who search ahead for rotten news before turning bearish are invariably doomed to failure.

BONDS: The collapse in bonds has been severe, and it's been an international cave-in. Bonds in Germany, France, Japan, the UK and the US have been hit and hit hard. In most cases the bond decline has been equal to two and in some cases even three years of interest. The smash in bonds has wiped out billions of dollars, yen, marks and pounds. It's basically a deflationary smash, since declining bonds mean (1) rising interest rates, and (2) a loss of liquidity.

The decline in both bonds and utilities (and I've said this many times) is basically bearish for stocks. The decline in bonds is also beyond the manipulative clutches of the Fed, and at this point I have to wonder whether the Fed wouldn't like to have its February boost in the Fed Funds back. What's been the Fed's reaction to



PTI NOTES : The PTI has been sliding gently lower, but I don't like to "jump the gun" on this valuable indicator. To turn bearish, I want to see the PTI break decisively below its 89-day moving average, and then continue down, all the while remaining below its moving average. So far, it should be remembered, all we have is the initial downturn in the PTI.



declining bonds and contracting liquidity? They just keep pumping -- "pumping up the volume."

THE PICTURE: At this point it's important to separate what we KNOW from what we think. What we know is that the stock market is, and has been, severely overvalued. It's been overvalued for three years. We also know that the stock market has been rising steadily and persistently while facing almost nothing in the way of corrective action. Finally, we know that the public has flocked into both the stock and bond markets via mutual funds, and when I say flocked in, I mean the public has come in with multi-billions of dollars, all the while cashing in their CDs (switching from low-yielding CDs to equities) at a frantic rate.

COMMENTS: I have a few additional thoughts and observations that I want to include here: (1) One widely-held opinion among bullish analysts is that "the stock market is not expensive, since we must judge market yield in relation to short-term rates. Since short rates are now extremely low, the stock market compares favorably on this basis, and, in fact, the market may actually be underpriced in relation to short rates."

Frankly, I've never seen so much publicity regarding the interest rate to market yield relationship. As a bullish argument I don't trust it. The strict Dow dividend-yield gauge has proved to be valid for decades, and the current "low short rate" argument smacks too much of "this time it's different."

(2) The stock market tends to go down in mirror fashion to the way it went up. If this holds true, then the next bear market might be fated to be one of the most persistent and costly in market history.

(3) As a matter of interest, I note that the "Percentage of Undervalued Blue Chip Stocks" (see page one statistics) is still only 9%. This percentage has held at 10% or below for almost three years, the longest period of stock market overvaluation in history. And it has me thinking that the next bear market will take stocks to the other end of the spectrum -- to extreme undervaluation. This should produce (near the bottom of the bear market) a reading showing that 85% to 90% of all stocks are down in the undervaluation zone (this in turn will mean very high yields, with the dividend yield on the Dow near or possibly above 10%).

(4) In a previous Letter I noted that this market has not suffered a decline of as much as 10% in any of the last three years. This has never happened before in stock market history. As a rule, when two years go by without so much as a 10% decline, then the third year produces a whopper of a decline. Note that at this time we've gone three years (1991-93) without a 10% decline, and now we're into a fourth year in which (so far) the market has not produced so much as a 10% decline.

How could this happen? How could three years have passed without a significant correction? The answer -- steadily declining interest rates plus amazing complacency on the part of stockholders. Is it possible that 1994 will be the fourth year without so much as a 10% decline? Anything is possible where the stock market is concerned. But I believe that it is highly unlikely that we will get by this year without a major decline. In fact, based on today's extreme overvaluation, I feel that probabilities favor a primary bear market to start sometime in 1994.

How will it start? Brace yourself -- it may have already started. In Letter 1141 I noted that the last joint highs of the D-J Averages were respectively **3978.36** for Industrials and **1862.29** for the Transports. For a reconfirmation of the bull market, it will be necessary for the two Averages, I repeat, both of them -- to better those highs. If one or both fail to better the preceding highs, a bear market will have been in progress. So write those numbers down, they are critically important.

CONCLUSION: The Averages recorded March lows of 3809.23 (Industrials) and 1729.87 (Transports). But on the most recent decline the Transports broke below their 1729.87 low (see page 1 chart). Industrials did not confirm, and that non-confirmation set off a rally. The question: will Industrials hold above **3809.23** or won't they? In the meantime, the bonds break to new lows, putting continuing pressure on the stock market.

INVESTMENT POSITION: The bull is out of the box and a question mark is in. The question mark simply means that the primary trend of the stock market is in question. As soon as I have definitive evidence of the direction of the primary trend, I will place either a bull or a bear in the box. But removing the bull from the box should NOT be taken as a vote of confidence in this market.

For those who follow the formula of buying the five top yielding Dow stocks each year, here's the current list: Texaco -- 4.78%; Woolworth -- 4.73%; Philip Morris -- 4.65%; Exxon -- 4.32%; Chevron -- 4.12%. Buying the top five yielders each year has been a money maker -- except, of course, during a bear market. But high yield does tend to be a buffer during a bear market.

My own position continues to be cash (T-bills, money market funds) plus gold and gold shares. I'm well aware that many leading analysts are of the opinion that because of low interest rates, no bear market can start here. The next three or four months should test the validity of that opinion. In the meantime, be careful.

CONSPIRACIES? Question: Russell, every time gold moves near to the 390 area it seems as though someone or some group knocks it down. Is the Fed doing this or is some other central bank in the act? Is gold being manipulated?

Answer: Who cares? The much more important question is -- whether the primary trend for gold is up or down. I believe the primary trend of gold is bullish. If that's the case, then even if there is some secret conspiracy to knock gold down via derivatives or the Fed's "stabilization fund" or some other device, fine, let them try. The fact is that if someone is trying to knock gold down to keep it below say 390, it's a testament to gold's strength that gold continues to come back to attack the 385-390 area.

The primary trend is the single most powerful trend in any market. If someone is manipulating gold to the downside, all it means is that gold is gradually moving into stronger and stronger hands. The longer a primary bull trend is "held back," the more explosive the rise when the bear forces are finally exhausted.

Again, I don't really know if anyone is conspiring to keep gold down. But if someone is, then they are wasting their ammunition. And the longer they fight the trend, the more exhausted the manipulators become and the stronger the underlying trend.

Question: While I'm at it, what about the conspiracy theories I hear so much about -- the Council of Foreign Relations conspiracy, the "One World" conspiracy, the Zionist (Jewish) conspiracy, etc.?

Answer: Although I've received literally hundreds of letters about this, I've never confronted the question before in these Letters, but here goes. I get numerous right wing newspapers, magazines, and advisories -- and I mean hard-right wing. Many of these writers are sincerely bitter about what has happened to this nation, and their bitterness has turned to extreme anger and in many cases anti-semitism. Some of what the right wingers claim is correct, some is not. One area the right-wingers center on is the Federal Reserve. Personally, I believe the Federal Reserve is unconstitutional. I think that a private banking monopoly issuing paper money based on debt is against the expressed intention of the Constitution, and I'm not even certain that taking money from one group and giving it to another is constitutional.

I've studied the Fed situation carefully for a long time. The original concept of a US central bank was the work of a small group of men working in total secret. The brains behind the Fed script was clearly Paul Warburg, a German Jew. I've read extensively about the Warburgs. I believe that Paul Warburg meant well, even if I firmly believe that the concept of a central bank is directly contra to the Constitution (Congress alone has the right to create or issue money). In other words, I think the Federal Reserve is an engine of inflation and an unconstitutional disaster. However, I don't think the creation of the Fed was part of a conspiracy to undermine the nation (the Fed, of course, was modeled after the European central banks).

As far as the Jews are concerned, being a Jew myself, I feel I have a special insight into the supposed insidious "Jewish conspiracy," which (along with the Rockefellers and other assorted groups) is planning to control the world. My view is that when you get three or four Jews together, it's hard enough to get them to agree on anything, much less an all-encompassing plot to take over the globe.

Then why, I am asked, have the Jews (who make up such a small percentage of the world's population), why do they have so much power in public relations, media, Hollywood, newspapers, government, etc.? My theory -- the Jews have been persecuted steadily for 5,000 years. In effect, it's really amounted to the survival of the fittest. Jews who were the smartest or the best at staying alive tended to be the survivors. As a Jew, if you didn't have brains you didn't make it to old age. Actually, I sometimes wonder why the anti-Semites don't become bored with anti-semitism. I mean, 5,000 years is a long time to dwell on one stupid theme. But an international Jewish conspiracy, where is it? I read about it all the time, but I've yet to see any actual evidence of it (maybe the Jewish conspirators just won't let me in on their conspiracy to take over the world).

You want a possible conspiracy, try this for size. When Vince Foster (the Clintons' personal lawyer) "committed suicide," the gun was in his right hand, although people who knew him said he favored his left hand. Foster's body was strangely lying in a straight line, although people who are shot usually crumble. On the day of Foster's death, his office was neither promptly nor properly sealed. Administration officials revealed only later that in the interim, documents, files and even the contents of a trash can were spirited away. Administration officials waited a full day before turning over Foster's suicide note, a note which had been torn into 27 pieces. Furthermore, White House counsel Nussbaum exerted tight control over the investigation, restricting investigators' access to Foster's personal papers. And get this -- despite many media requests, authorities have still not released the police report on Foster or the full autopsy report. The talk, of course, is -- cover up. And rumors are flying -- everything from Hillary having an affair with Foster to plots involving Whitewater or some other secret scandal. Said political analyst Stuart Rothenberg, "It's a function of the public's doubt about Bill Clinton, his family and, frankly, everyone who surrounds him." Russell comment: I still find it hard to believe with all the scandal and dirt surrounding Clinton and his many chronies, that the American public accepts Clinton at all. I take it as simply an ominous sign of the times.

STAYING IN BUSINESS: This marks (gulp) the 36th year that I've been writing Dow Theory Letters. Unfortunately (for me) this business doesn't get any easier as the years go by. But I love it, and I wouldn't want to do anything else. I stopped advertising Dow Theory Letters about four years ago, although I still do some direct mail. But happily, subscriptions are now at about the highest level ever. I've been asked by other advisers how I can stay in business without doing any advertising. I tell them I can do it because I have what I'm sure is the highest renewal rate in the industry. Why the high renewals? I dunno, maybe subscribers like me, maybe you feel sorry for me, maybe I've simply become a habit, or maybe you're interested in what I'm thinking and saying.

One thing I did do I think helped me through the years. I decided to write an advisory in my own words, the way I thought and the way I talked. I was sick of advisories that sounded like a college professor's stilted thesis. And I think that made a difference. I believe subscribers want to know who's writing the report, what he's like and what he's doing with his own money. At any rate, that's the way I wanted to write, and it's still the only way I want to write.

NOTES & QUOTES: Shredding records, unethical briefings, advance information, conflicts-of-interest, hiding papers -- the Whitewater scandal and cover-up has become so flagrant, so sickening, that even the deeply Democratic *New York Times* saw fit to publish this lead editorial:

White House Ethics Meltdown

From now on, President Clinton says, "everyone will be much more sensitive" about attending the improper meetings between White House and Treasury officials concerning the Resolution Trust Corporation's inquiry into a savings and loan association with close ties to him and Mrs. Clinton.

Sure, that would be progress. But Mr. Clinton's tepid response explains why his Administration is easily the most reckless in interfering with the integrity of Federal investigative agencies since that of Richard Nixon.

Treasury counsel, for briefing Mr. Nussbaum in advance on where the supposedly independent R.T.C. investigation was going.

It is, of course, long past time for Mr. Nussbaum to be dismissed. He seems to conceive of being "the President's lawyer" as a license to meddle with the integrity of any Federal agency. First, he and his staff tried to involve the Federal Bureau of Investigation in a politically inspired White House purge of employees of its travel office. When Vincent Foster, the deputy counsel, commit-

Whitewater is beginning to take its toll, with the departure of White House Lawyer Bernard Nussbaum. Adding to Clinton's troubles, Deputy Treasury Secretary Roger Altman may soon be leaving, and Treasury Secretary Lloyd Bentsen will probably be gone by year-end. A major blow to the Clintonites is the signing off of Senate Majority Leader George Mitchell. And with Dan Rostenkowski (Chairman, House Ways & Means Committee) in legal trouble, Clinton could have a hard time passing major bills. Meanwhile, according to Robert Novak, David Gergen is quietly passing the word that he will not be a spokesman for Clinton on Whitewater. The Republicans now have the bit in their teeth -- last week Sen. Phil Gramm said Clinton is getting "deeper in the hole" that threatens his presidency, and Sen. Alfonse D'Amato stated that as a result of the administration's attempt to stonewall the investigation, the issue has "the potential of being as great, if not greater, than Watergate." Russell comment: Cal Thomas, columnist for the *LA Times* writes, "Whitewater threatens to engulf the Administration. And there is this historical difference -- Watergate didn't have a body."

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Social Security -- this program has become essentially a transfer tax, a generational transfer of wealth from younger people to older people. Here's what's happened to this misconceived, mismanaged mess of a program. The program is calculated by figuring out the taxes that members will pay during their lifetime and then

subtracting the benefits they'll get back from the government. If you were born in 1910, SS is a good deal in that your lifetime tax rate is only 27.2% of your income. The average baby boomer born in 1950 can expect to pay out 33.2%. For those born in 1970 the tax goes up to 36.5%, and for those born in 1980 it goes up to 36.9%. Older people have done particularly well, since the taxes were relatively low during the time that they were paying, but SS taxes have risen steadily over the years due to inflation. Today, SS is a rotten deal.

The OMB has calculated what people can expect to pay in or get back from SS over the rest of their lives. Examples: if you're a woman born in 1922 you're in good shape, your tax payment will be a positive $124,600, since you'll be getting back a lot more than you've paid in taxes. But the average man born in 1952 will pay in $171,000 more to the government than he'll receive. If you were born in 1967, you'll pay out a net $203,000 more than you'll receive. And if inflation runs higher, you'll do even worse. Russell comment: If you put the same money you are now paying to SS into a decent retirement plan that is properly funded, you would come out far ahead of anything you'll ever get from SS. Somewhere ahead, a younger generation will probably rebel against the whole SS scheme, claiming it's a scam and a Ponzi scheme. And for them, it will be.

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You're a partner at Goldman Sachs, and you made $5 million this year, and you think you did OK. Of course, you did, but check this out -- Julian Robertson who runs New York's *Tiger Management* (a hedge fund) received close to $350 million last year, according to industry sources.

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The 500 point overnight explosion in the yen a few weeks ago cost speculators hundreds of millions of dollars. Then add the smash in European bonds, and you're talking additional massive losses, particularly among hedge funds and the big banks (many of the banks are now major speculators in stocks, bonds and particularly derivatives). You know something -- so far, it hasn't been an easy year for traders or speculators.

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The US tax system continues to be a nightmare for all of us who have to pay taxes. The IRS has more than 10,000 pages of tax rules and regulations on its books, making the whole thing literally incomprehensible, even to IRS agents or accountants. Experts figure Americans spend 6 billion hours a year just filling out the IRS forms. Steve Hayes, who founded *Citizens for an Alternative Tax System*, figures that a national sales tax of 16% would bring in the same amount of money that our current ridiculous tax system brings in. Furthermore, a national sales tax would eliminate the $7 billion it costs to carry the IRS. So why don't we change the system? Easy, the politicians want the current system. It keeps the power to tax in their hands. The pols decide who to tax and how much to tax. And did you ever see a Congress that wants to give up any power?

Meanwhile, selected Washingtonians sense the public's anger at the whole idiotic tax system. Four powerful US senators will introduce two separate bills that are designed to replace much of the IRS tax code. They're talking about a consumption tax. At any rate, for the first time serious debates will be coming up regarding the whole US tax "system." It's about time.

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Can the high-wage, high-tax West compete with low-wage, low-tax Asia? We'll find out, won't we. Here's a comparison of Capital Gains (CG) taxes and holding periods. Hong Kong, South Korea, Taiwan -- no holding period and no CG tax. Japan -- no holding period and a 5% CG tax. France -- no holding period and a 16% CG tax. Canada - no holding period and a 17.5% CG tax. Sweden -- two year holding period and an 18.8% CG Tax. US -- one year holding period and a 28% CG tax. UK -- no holding period but a 40% CG tax. Australia -- one year holding period and a 50.25% CG tax.

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I clipped this from London's *Financial Times*. While Hong Kong builds capital, the US builds debt. Who'll be the winner in the long run, Asia or the US? I wonder.

US balanced budget law back on shelf

By Jurek Martin in Washington eviscerated.

The amer fede back year

Hong Kong cuts taxes after HK$15bn surplus on budget

By Simon Holberton in Hong Kong

Hong Kong announced cuts in corporate and personal taxes yesterday after producing a budget surplus this year of HK$15bn

percentage point to 16.5 per cent. This returned it to the level of two years ago before he raised it in his first budget. He also increased personal tax allowances beyond the inflation rate, some by as much as three times.

nomic forecast suggested that in China's first year of administration of Hong Kong, 1997-98, the colony's fiscal reserves might amount to HK$141bn. Including accumulated reserves in the land fund for China, a special fund set

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Speaking of Congress can you believe this? Sen. George Mitchell (D-Maine) recently proposed legislation (S-1226) that exempts Congress from any nationalized health-care service. Congress knows what's good for it. But damn it, I'd like a law mandating that Congress be subject to ALL the laws that you and I are subject to (Congress, by the way, is not even subject to Social Security).

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China: Two weeks ago Zhu Rongji, China's senior vice-premier in charge of the economy, virtually ruled out any measures to slow down the economy. The Chinese economy grew by 13% last year, and will probably grow by around 9% a year for the foreseeable future. Retail sales grew by more than 15% in December compared with last year, and the cost-of-living in 35 major cities increased by 24% in the 12 months to December. Meanwhile, the population of Hong Kong rose 2% in 1993 to a record 6 million. The Hong Kong territory comprises just 400 square miles.

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Russia is facing a double population crisis -- a dramatic rise in death rates and a sharp fall-off in birth rates. In the past year alone the death rate has jumped 20%. One expert calls it a "psycho-social crisis" in which greatly rising insecurity and worry about crime, inflation, hardship and change play a large part in the rising death rate. Researchers in Russia believe that the average age for male mortality has sunk to 59, far below the average rate in the rest of the industrialized world.

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The unemployment statistics in the US are far from accurate, mainly because official unemployment rates are understated. For example, discouraged workers, people who have given up looking for jobs, are not counted as unemployed. Under the Bureau of Labor Statistics' new rules, a discouraged worker who has not looked for a job for a year is no longer considered discouraged, he's just dropped off the statistical charts. The estimate is that there are at least 600,000 to a million of these. The job crisis is not limited to the unemployed, however. Recent statistics show that college-educated men in their 40s and 50s, ordinarily considered an elite group at the peak of their earning power, are now experiencing a sharp decline in wages. Experts in the field say that a statistic that showed the number of people who wanted a job but could not find one would be astonishingly high.

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Sony, which lost more than $100 million on the latest Arnold Schwarzenegger epic ("The Last Action Hero"), is rumored to want to sell part or all of its Hollywood properties (Columbia Pictures, Tri-Star, etc.). The original fear was that Japan was taking over Hollywood. Now the word is that Hollywood really "took" Japan. Sony made Peter Guber and Jon Peters wealthy men when they paid the two $200 million to buy out Guber-Peters Entertainment in '89. Peters left in '91, however. Next year Guber will collect a goodly share of the huge Sony bonus pool, based on the increased asset valued gained by the studio during his tenure (Guber's take could be tens of millions). On top of the initial $6 billion Sony paid for Columbia-Tri Star, Sony went through another $2 billion trying to get it right.

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Speaking of the movies, Europe is now trying to protect itself against Hollywood. In Europe, 80% of their entire box office consists of Hollywood films (France is the exception, showing only 60% Hollywood fare).

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Deals: Now that Viacom has taken over Paramount, analysts are wondering whether it was such a brilliant deal after all (both Viacom and partner Blockbuster's stocks are well down). The deal comes with debt of $10 billion, and loser Barry Diller may yet have the last laugh. Furthermore, with stockholders now suing, the deal could even be in for trouble . . . Wall Street is talking about the stupidity of the FCC announcing cable rates being rolled back in the midst of the Bell Atlantic-Tele-Communications merger negotiations. Of course, the deal fell apart on the FCC news, and the whole cable TV industry is now on the defensive.

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The Fed has changed its mind regarding what are its inflation barometers. What's "in"? Gold prices; long-term interest rates and commodity prices; capacity utilization; real short-term interest rates; unit labor costs; figures on bank lending. What's "out"? Various categories of money supply; survey of prices paid by manufacturers for supplies; the consumer price index. Russell comment: The Fed has finally decided that it's been looking at lagging indicators instead of actual market indicators. Of course, what the Fed is really looking at is gold, and this fact was emphasized in the lead-off editorial in the Feb. 28 *WSJ*.

Greenspan Takes the Gold

The sky didn't fall, markets didn't crash, and no one in Congress or the MIT economics department tore his garments. None of this happened last week even though Federal Reserve Chairman Alan Greenspan announced that he's a gold bug.

We point to these remarkable non-events because for years, even decades now, gold has been the four-letter word of government finance. Central banks may store gold in their vaults as reserves, and gold may be the one thing that no one ever throws

the Phillips Curve. ("What appears to be a trade-off between unemployment and inflation is quite ephemeral and misleading.") Then he ditched the M's. ("The signals they have sent in recent years have been effectively jammed by structural changes in financial markets.")

So what does he steer by? "The price of gold, which has been especially sensitive to inflation concerns," said Mr. Greenspan, adding that "the exchange rate and the term structure of interest rates can give important

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Is the US locked into an extended period of low growth? It seems so. Now it's nearly three years after the official "end of the recession," and the average Gross Domestic Product has been only 2.4%, half the 5% GDP usually seen at similar points in recoveries.

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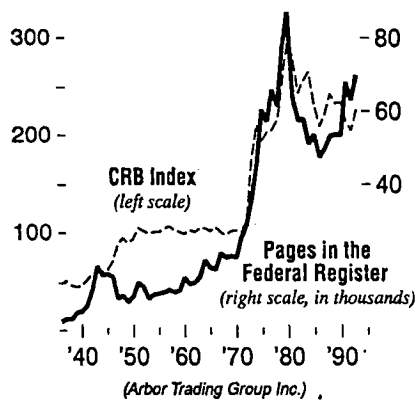
The twin trends of government regulations and inflation are of interest here. Only two presidents have seen regulations increase rather than ease in their first year of office -- under Jimmy Carter regulations increased by 14% and Bill Clinton by 11%. This chart (courtesy *Investor's Business Daily*) shows the path of the two, and you can see that as the number of regulations increase, business costs increase, and those costs are ultimately passed on one way or another in the form of inflation.

Regulation & Inflation



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A few Letters ago I stated that the brokerage stocks have an excellent record of being stock market bellwethers, and I said that if I had to pick one stock as a general market barometer, it would be Merrill Lynch. Merrill is down from a high of 51 1/4 to 41, and the Brokerage Group is down 16% from its high. It's worth thinking about.

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My friend, Frank Holmes (President of *United Services Funds*) just got back from a trip to Bangkok, Thailand, Kuala Lumpur, Malaysia, Jakarta, Indonesia, Singapore, Hong Kong, Hanoi, Vietnam, and Shenzhen. Here's what Frank has to say: "Everywhere we went we were amazed at the work ethic. When I went jogging at 6AM, the streets were already crowded with people hurrying to set up shop, rushing to work. At 11PM, when we were returning from meetings, the streets were still filled with people, many of them just returning home from the office. In Shenzhen (China) we counted 24 construction cranes erecting skyscraping offices and towering hotels. New cars, even Mercedes, zoomed by on massive modern highways. Construction of this magnitude is creating more jobs and a personal-income multiplying effect. In China the shops are stocked and crowded with people filling their bags. Many people have cellular phones and pagers. What a contrast with Russia. In June, 1993, I visited Russia, and I saw roads full of potholes and rusting old cars. The people waited in lines to buy even the most basic goods . . . When traveling down a river in Saigon, we saw straw shacks with TV antennas and satellite dishes rising from their thatched huts. Everyone watched MTV and CNN."

Russell comment: I said this years ago -- TV is changing the world in that it has showed the world what the good life (in the US) looks like. TV was the trigger that collapsed communism in Russia. When the Soviets leaders realized that the world was passing them by in TV, copiers and computers, they decided that they had to give their populations access to the electronic world. When the people of Russia saw what capitalism really looked like, the fate of communism was sealed. American movies have become the world's premier entertainment. TV, film, computers, electronics, they all militate towards free enterprise and knowledge. They free men's minds, which is poison for both fascism and communism.

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Term Limits: Now that the voters in many states have passed term limit laws, the poor politicians are on the spot. Many of them have never worked at a real job in their lives, so when they're tossed out, what do they do? They simply go for another government job. For instance, Controller Gray Davis has held top appointed and elected state offices for the past 20 years, he's running for lieutenant governor of California. Willie Brown will be forced out of a 32-year career here as assembly speaker, so what will Willie do? He'll run for the state senate. Senate President Pro Tem David Roberti, who has served 28 years in the Legislature, he'll run for state treasurer. Another 13 incumbents in California are running for statewide offices or the Board of Equalization this year. It's really kind of sad when you think about it. These pols really don't know how to survive outside of the government.

QUOTATIONS FROM THE CHAIRMAN, TRANSLATED

When the chairman of the Federal Reserve Board speaks, people listen. Then they scratch their heads and try to figure out what he said. Fed chairmen have a long tradition of being cryptic so they can hint at future actions without being locked into any particular course. Here are some examples of Chairman Alan Greenspan's FedSpeak at a Feb. 22 congressional hearing:

What he said: *"Our monetary policy strategy must continue to rest on ongoing assessments of the totality of incoming information and appraisals of the probable outcomes and risks associated with alternative policies."*

What he meant: Setting interest rates requires a lot of guesswork.

What he said: *"When the Federal Reserve tightens reserve market conditions, it is not surprising to see some upward movement in long-term rates as an aspect of the process that counters the imbalances tending to surface in the expansionary phase of the business cycle."*

What he meant: The Fed's rate hike tanked the bond market because of fears of strong growth and inflation.

What he said: *"Our long-run strategy implies that the Federal Reserve must take care not to overstay an accommodative stance as the headwinds abate."*

What he meant: We're gonna tighten some more.

Owen Ullmann

Courtesy of *US News & World Report.*

ITEMS: The Fed continues to pump as Adjusted Reserves (Dec. 22 to Feb. 16 period) rise at a wild annualized rate of 31.2% . . . T-bill rate in the US climbs to 3.61%, while some long Treasury bonds hit yields of 7% . . . Indications of a commercial real estate boom appear in Britain . . . Residential real estate boom hits Idaho, Utah, Colorado, Nevada . . . German money supply rising at an annualized rate of 20%.

GOLD: I cut this piece out of the March 9 *WSJ*. And it caused me to wonder whether this article didn't correspond with a bottom for the gold correction, a correction that began last January (see gold chart below). When national newspapers are telling us "that the future looks dim" for gold, it's a fairly reliable sign that we've seen the END of the correction.

Gold's Future Looks Dim As Hedge Funds Sell Off

COMMODITIES

By Michael R. Sesit
And Nicholas Bray
Staff Reporters of The Wall Street Journal

LONDON—Hedge funds—those aggressive investment partnerships that bet huge sums on currencies, bonds and stocks in search of quick profits — are hammering another market. This time it's gold.

lower," says James M. Connors, a vice president at Kidder, Peabody & Co. in St. Louis.

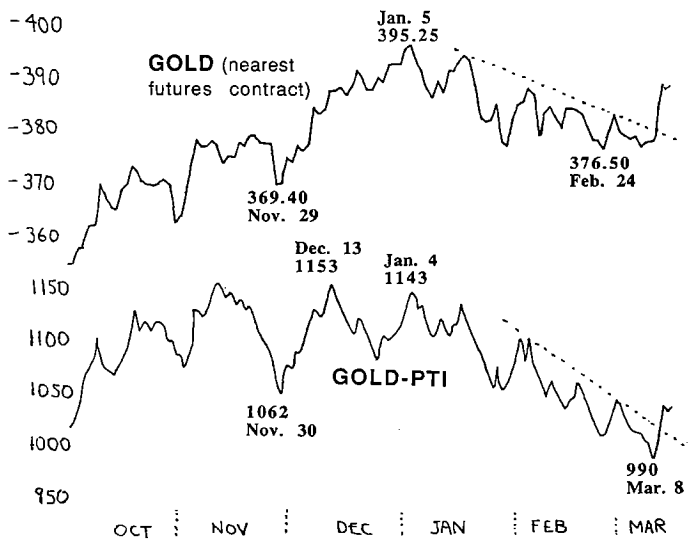
He notes that in 80% of the years since the first futures contract began trading in 1976, gold and other precious-metal prices have climbed to their highs in the winter and fallen to their first significant low of the year in either March or April.

"I like trades that are 4-to-1 in my favor," says Mr. Connors. "I'm not going

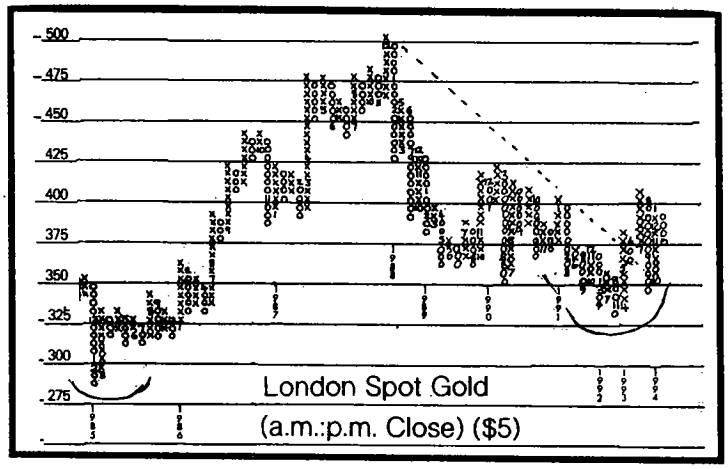
During the recent rise to the January high, gold stocks moved way ahead of gold, the metal. In the past, that's always been a problem. The result -- usually a secondary decline in gold and a fairly severe corrective decline in the gold shares.

The whole process shows up very clearly on the accompanying chart of gold and the Gold-PTI. The G-PTI is heavily weighted with both gold and gold shares, and I've found that the relationship between gold and the G-PTI is critically important.

The G-PTI recorded its high of 1153 on Dec. 13. A few weeks later gold rose to a Jan. 5 peak of 395.25. The Jan. 5 gold high was not confirmed by the G-PTI, and a correction began. The correction ran well into March. But on the decline, as noted in the last Letter, the situation was reversed, and a downside non-confirmation appeared. As you can see on the chart, the G-PTI broke well below its Nov. 30 low, but gold held a full six dollars above its own Nov. 29 low.



This action strongly suggested the turn. On March 10 both gold and the G-PTI rallied above their respective declining trendlines (gold was up a whopping $8.10 for the day). With the downside non-confirmation and then the trendline reversals, the basic uptrend in gold and shares is once again in force.



For new subscribers I'll repeat -- I do believe that a gold bull market is in progress, but as I said all along, the early stages of any bull market tend to be tedious, difficult, and tough on the nerves. This gold bull market has proved to be no different.

My friend, David Fuller (*Fuller Money*, 7 Swallow St., London WIR 7HD) includes this long-term chart of gold in his latest report. Note that the gold action has assumed the pattern of a "rounding bottom" with the low of the formation well above the preceding major low which was recorded back in the mid-1980s (each X or O on this chart equals $5). The chart clearly shows that a major upside breakout would entail a rise by gold to **415.** A further advance to **435** would put gold in line for a test of the critical 500 level. Note on this chart that gold has reversed the declining trendline, a trendline that begins at the 505 high. It's also important to note that the recent gold action has taken place ABOVE the declining trendline.

Although gold does not have to depend on inflation to advance, knowledgeable investors have learned to expect inflation, and they protect their purchasing power by buying gold. I've said this before, and I want to repeat it -- *"Government debt is the father of inflation."* Why? Because modern governments don't pay off their debts, they inflate them away.

Along these lines here are some rather shocking statistics from the latest issue of *Gold Discipline Amendments* (PO Box 370353, Denver, CO 80237). "The Federal Reserve looks at all government securities outstanding, which means it includes what the government spends 'off budget.' So the real US deficit for fiscal year '93 was $409 billion, 1992's deficit was really $469 billion, and '91's deficit was $369 billion. As for the total government debt, this does not stand at $4.5 trillion. The FRB reports total outstanding government securities at $5.1 trillion as of FY '93 . . . According to the FRB, *total credit market debt* -- all debt includes US tax exempt securities, corporate, mortgages, consumer credit, bank loans, open market paper and other loans -- totaled $15.565 trillion at the end of the third quarter of '93. The ratio of this debt to GDP is the highest the country has ever seen." Russell comment: Is it any wonder that there's inflation in our future?

LATE NOTES: It's impossible to make a valid call on the stock market here (in other words, the jury is still out). The Dow has resisted on the downside, bonds look oversold, and Whitewater is just another element adding to the confusion. The PTI has been sliding gently lower, but it's still holding ABOVE its 89-day moving average.

Critical numbers to watch -- on the upside Dow **3978.36,** Transports **1862.29.** On the downside (Transports have already broken), Dow **3830.62.** For gold the near-term bullish target (spot) is 396, downside break would be 375.

Wise guy Washington columnists are asking, "Would Bill throw Hillary to the wolves?" Russell answer, "No way, no way at all -- they're married, remember?"

NEXT MAILING: March 30, 1994